July 29, 2011

Via Electronic Mail

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RE: Proposed Rule on Credit Risk Retention (Federal Reserve: Docket No. R-1411; RIN No. 7100 AD-70; OCC: Docket No. OCC-2011-0002; FDIC: RIN No. 3064-AD74; SEC: File Number S7-14-11; FHFA: RIN 2590-AA43; HUD: FR-5504-P-1)

Ladies and Gentlemen:

The PNC Financial Services Group, Inc. ("PNC") appreciates the opportunity to comment on the proposal by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, the Federal Housing Finance Agency, and the Department of Housing and Urban Development (collectively, the "Agencies") to adopt regulations to implement the credit risk retention requirements of section 15G of the Securities Exchange Act of 1934

(15 U.S.C. 78o–11), as added by section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[1]

PNC is a diversified financial services company with approximately $263 billion in assets, as of June 30, 2011. PNC businesses engage in retail banking, corporate and institutional banking, asset management, and residential mortgage banking. PNC provides many of its products and services nationally and others in PNC's primary geographic markets in Pennsylvania, Ohio, New Jersey, Michigan, Maryland, Illinois, Indiana, Kentucky, Florida, Virginia, Missouri, Delaware, Washington, D.C., and Wisconsin.

The credit risk retention regulations will apply to the securitization of residential mortgage loans, commercial mortgage loans, including multifamily mortgages, automobile loans, and other assets. PNC plays varied and important roles in the origination and servicing of a diverse array of assets that are securitized. PNC Mortgage, a division of PNC, originates first-lien mortgage loans throughout the United States and PNC also originates home equity closed- and open-ended residential loans. PNC Mortgage is one of the top 10 residential mortgage originators and servicers nationally with a loan portfolio of more than $139 billion as of December 31, 2010. PNC's mortgage team serves our customers through 2,480 retail banking branches and our network of 185 retail mortgage offices in the continental United States.

PNC also acts as originator, loan contributor, master servicer and special servicer for commercial and multifamily property loans. From 1998 through 2008, we originated approximately $16.5 billion in financing for 2,187 commercial and multifamily properties. As of June 30, 2011, PNC services 13,430 loans under servicing contracts with commercial mortgage-backed securities ("CMBS") trusts, is named special servicer on 139 trusts, and is actively handling the special servicing for 433 loans totaling $5.9 billion in unpaid principal balance. In addition, PNC provides client financing in the form of securitization facilities in a variety of asset classes, including, but not limited to, auto loans, trade receivables, corporate loans, corporate fleet lease, etc. Since 1995, PNC has provided in excess of $28 billion of credit to our corporate client base through securitization products.

1. Introduction

Section 15G is designed to address concerns with the "originate to distribute" securitization model whereby originators and sponsors of securitizations had little incentive to mitigate credit risk because it could be transferred so easily to investors through the securitization process. The statute is intended to help prevent this misalignment of incentives and instead provide incentives for sound underwriting in the future by requiring "securitizers" or originators of securitized assets to retain a measure of credit exposure for those assets. PNC supports the purposes of section 15G and believes that, if appropriately implemented, it has the potential to help ensure that the market for assets that are securitized, particularly the residential mortgage market, avoids returning to disfavored past practices.

Section 15G provides an exemption from the credit risk retention requirements for qualified residential mortgages ("QRMs"). As discussed in more detail below, PNC believes that a sufficiently narrow definition of QRM is important to achieve two objectives. First, QRM should be narrow enough to ensure that only very high quality residential mortgage loans are

[1] Credit Risk Retention, 76 *Federal Register* 24,090 (Apr. 29, 2011) ("Proposal").

exempt so that a significant portion of the mortgage market is subject to risk retention requirements. An exemption that covers too broad a portion of the residential mortgage market and makes QRM the norm, rather than an exception, would undermine the purpose of the statute to align the interests of originators, sponsors and investors. Second, a narrow QRM definition should help ensure that the non-QRM market has enough liquidity in the secondary market so that non-QRM loans will not be subject to a high "liquidity premium" solely due to the Agencies' regulations.

We believe the Agencies should proceed cautiously in expanding the QRM definition from the Proposal. However, after analyzing historical mortgage loan data, PNC believes that expanding the scope of QRM to the alternative QRM definition proposed by the Agencies ("Alternative QRM Approach")[2] would achieve the above objectives while permitting some additional mortgages to come within the definition. For the reasons discussed below, we would have serious concerns if the definition were expanded beyond the parameters of the Alternative QRM Approach. We also recommend striking the proposed loss mitigation standards for QRMs.

We are firmly in agreement with industry trade associations and other commenters that the proposed Premium Capture Cash Reserve Account ("PCCRA") as proposed is unworkable and should be eliminated. Interest-only ("IO") strips in securitizations serve bona-fide purposes that are unrelated to reducing or eliminating the economic consequences of risk retention for sponsors. Effectively prohibiting such strips by requiring that the proceeds from their sale be used as first-loss credit support through maturity would have serious negative unintended consequences for the mortgage finance market. Moreover, the PCCRA would have serious adverse consequences for certain securitization markets given the specific manner in which securitizations in these markets are priced and structured.

With regard to CMBS, PNC believes the Proposal should be revised in several ways to take into account the unique aspects of this market and to ensure that it remains liquid. The CMBS market has played an increasingly critical role in the financing of multifamily and other commercial real estate, successfully providing a mechanism for bond investors to provide capital to commercial real estate property owners through a securitization vehicle. The Agencies should take care to ensure the risk retention regulations do not stifle the market's continued development. We therefore support the Proposal's optionality in the acceptable risk retention structures for CMBS. However, we recommend significant changes to the exemption for qualifying commercial mortgages and modification to the conditions applicable under the third-party purchaser risk retention option.

Finally, we urge the Agencies, as permitted by section 15G, to limit to four years the duration that risk retention must be held for RMBS and to three years for all other asset classes.

2. Scope of QRM Definition

Section 15G directs the Agencies to define QRMs, which are automatically exempt from risk retention requirements. The statute gives the Agencies discretion to define the term, but directs the Agencies to take into consideration "underwriting and product features that historical loan performance data indicate result in a lower risk of default."[3] Section 15G also provides that the

[2] Id. at 24,129.

[3] Id. at 24,118.

definition of QRM can be no broader than the definition of qualified mortgage ("QM") under the Truth in Lending Act, which was amended by Title XIV of the Dodd-Frank Act.[4]

PNC supports the criteria used by the Agencies to define QRM. In particular, we support the Agencies' proposal to include in the definition (i) loan-to-value ("LTV") ratio limits, (ii) down payment requirements, (iii) front-end housing debt-to-income ("front-end DTI") limits, (iv) back-end total debt-to-income ("back-end DTI") limits, and (v) other loan characteristic requirements, such as no reverse mortgages, no negative amortization or interest-only features, no balloon payments more than twice as large as previous scheduled payments, no prepayment penalties and no simultaneous second liens (i.e., piggy-back loans) for purchase mortgages.

It is vital that the QRM definition provide for sufficient liquidity in the secondary market not only for QRMs, but, more importantly, for QM loans that do not meet the definition of QRM. As noted, QMs are presumed to meet the ability to repay standards in the Dodd-Frank Act. Mortgage originators likely will attempt to avoid the substantial risks of making loans outside the requirements of QM, so that QM is likely to serve as a "soft cap" on the mortgage market.[5] For loans within the QM universe, the choice is not between QRMs and no loan availability for those borrowers who do not qualify for a QRM, as some have asserted. Instead, if the "non-QRM QM" segment of the QM market is large enough, prudent lenders will have adequate access to secondary market liquidity and, thus, have both the incentive and the ability to underwrite loans to the forthcoming QM definition. This, in turn, will ensure that QM borrowers—including low- and moderate-income borrowers—who cannot qualify for the strict requirements of a QRM loan will continue to have access to loans on reasonable terms.

On the other hand, a QRM definition that is too broad will result in inadequate liquidity in the secondary market for non-QRM QMs. Such a result will make these loans more costly due to an artificially imposed "liquidity premium" and could potentially deny creditworthy borrowers at the lower end of the QM market the opportunity for homeownership.[6] Because of this, PNC believes that it is essential that the Agencies should attempt to define QRM so that the QM market going forward is roughly equally split between the QRM and non-QRM QM segments.

Additionally, because QRMs are completely exempt from the risk retention requirements, QRMs should have characteristics that ensure they are of very high credit quality with very low risk of

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[4] Title XIV of the Dodd-Frank Act revised the Truth in Lending Act to require creditors to make reasonable and good faith determinations that a prospective borrower under any residential mortgage loan has a reasonable ability to repay the loan. Section 1412 of the Dodd-Frank Act provides that QMs are presumed to meet this standard and provides a detailed definition of QMs (e.g., no negative amortization or interest-only features, points and fees limits, no term beyond 30 years, and no balloon payments).

[5] Moreover, to the extent non-QM loans are made, these loans likely will be priced significantly higher than QM loans. The difference in availability and pricing of QM and non-QM loans results not from the definition of QRM (which is bounded by statute within the definition of QM), but from the QM standard in the Truth in Lending Act and the legal risks, noted above, that lenders will take on by making non-QM loans.

[6] It is important to recognize that, to the extent QRM borrowers are more creditworthy than non-QRM borrowers, it is natural to expect some pricing difference between a QRM and a non-QRM due to differences in credit risk. Indeed, risk-based pricing is a key element of sound underwriting and would occur even in the absence of a QRM definition. An overly broad QRM definition, however, runs the risk of adding a significant liquidity premium to non-QRM loans that is not credit-based, but exists merely due to a regulatory definition that results in a small universe of non-QRM loans.

default. Only in such circumstances is it reasonable to believe that the interests of originators, sponsors and investors are aligned sufficiently to obviate the need for any amount of risk retention.

As discussed in more detail below, historical mortgage data indicates that the proposed QRM definition, as well as the Alternative QRM Approach, would create large enough QRM and non-QRM segments of the QM market so that both segments would enjoy sufficient liquidity resulting in lower costs to consumers. In addition, these data indicate that loans meeting the proposed QRM or Alternative QRM standards would have a very low risk of default, even in periods of economic stress. For this reason, the proposed definitions will help ensure that the interests of originators, sponsors and investors are aligned in securitizations going forward. Moreover, this will help promote sustainable home ownership.

a. <u>Data Relevant to Determining Proper Scope of QRM</u>

With the principles discussed above in mind, PNC analyzed historical mortgage data from CoreLogic that started with a sample size of more than 55 million residential mortgage loans. The table in the Attachment shows both the size of the market and delinquency rates for QRM as defined: (i) by the Proposal, (ii) under the Alternative QRM Approach, and (iii) as some have proposed, to approximate the size of the entire QM market.

In considering market size, we screened out loans that would not meet the definition of QM, since, as discussed above, we believe QM is likely to serve as a cap on the market. Accordingly, we considered only single-family, owner-occupied loans that are fully amortizing with no negative amortization and have terms up to and including 30 years. In addition, since the statute directs the Agencies to consider historical loan performance in defining QRM, we believe that the expected level of serious delinquencies of qualifying mortgages is a key element that should be considered in assessing the proper breadth of the QRM definition. We support the Agencies' decision, in assessing delinquency rates in the Proposal, to use data on loans that have gone to foreclosure or that were ever 90 days or more delinquent.[7] We believe this measure most closely follows the statute's mandate for the Agencies to consider data that shows a "lower risk of default" and we followed this approach in our review.

Based on this review, and as discussed in more detail below, PNC believes that the Agencies have room to expand the QRM definition and continue to achieve the goals of the statute and promote liquidity in all aspects of the QM mortgage market. Specifically, PNC believes that the Agencies should define QRM consistent with the Alternative QRM Approach set forth in the proposal. We do not believe, however, that the Agencies should expand QRM beyond the Alternative QRM Approach.

b. <u>Agencies Proposed QRM</u>

As the Table 1 below shows market share and delinquency data for QRM as defined by the Agencies in the Proposal. From 2001 through 2011, 31.32 percent of the QM market would have been loans that met the proposed QRM definition. Looking just at 2010, which is the vintage of loans that is likely more representative of the post-crisis mortgage market, data indicate that approximately 40.19 percent of the loans estimated to be within the QM universe

[7] Proposal at 24,141-143.

would have met the proposed QRM definition.[8] These industry market share data indicate that, while the overall QM market achieves rough parity between the QRM and non-QRM segments for some years, for most years the non-QRM QM segment dominates the QM market. While this would ensure sufficient liquidity for the non-QRM segment, thereby avoiding artificially higher costs for consumers for such loans, this data also suggests there is room to expand the QRM definition to permit more borrowers to qualify for QRMs without adversely affecting liquidity for non-QRM QM borrowers.

For loans originated between 2001 and 2011, these data also indicate that all loans meeting the proposed QRM standards had a default rate of 0.65 percent, which represents 69,357 loans that would have gone into default. PNC believes that in considering delinquency data, the Agencies should be guided not only by data over multi-year periods, but also by performance in "stressful economic environments that combine high unemployment with sharp drops in house prices." The Agencies used this standard in developing the proposed QRM standard[9] and we believe that it is consistent with legislative intent. For loans originated in 2006 and 2007, the years with the highest default rates, these data indicate that loans meeting the proposed QRM definition had default rates of 2.17 percent and 2.02 percent, respectively.

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[8] The data for 2011 trends in the same direction, but the group of loans for this vintage is much lower than for the 2010 vintage.

[9] Proposal at 24,118.

Table 1. QRM as Proposed

Definitions:*	QRM Rule
Debt/Income	36
FICO	690
LTV	
Purchase	80
Rate Term Refi	75
Cash Out Refi	70

Year	% Share of total QM Mkt	Volume $B	Life to Date Default
2001	28.14	80.00	0.51%
2002	35.44	250.00	0.36%
2003	36.70	500.00	0.39%
2004	26.90	260.00	0.71%
2005	25.00	230.00	1.42%
2006	23.07	160.00	2.17%
2007	21.97	150.00	2.02%
2008	26.66	130.00	0.60%
2009	40.59	270.00	0.05%
2010	40.19	220.00	0.03%
2011	38.95	40.00	0.00%
Total:	**31.32%**	**$2,290B**	**0.65%**

Source of Data: CoreLogic (more than 55 million loans were analyzed)

* All loans are single family and owner occupied, with loan terms of up to 30 years. All loans are fully amortizing with no interest-only features. No front-end DTI screen was applied because data is not publicly available. A screen using a FICO score of 690 was used as a proxy for the credit history criteria for the Proposal.

c. Alternative QRM Approach

Under the Agencies' Alternative QRM Approach, which is shown in Table 2 below, LTV limits would be raised from 80 percent to 90 percent for purchase loans,[10] from 75 percent to 90 percent for rate and term refinancings (i.e., no cash out), and from 70 percent to 75 percent for cash out refinancings. A borrower's required down payment would be lowered from 20 percent to 10 percent of the property's market value or purchase price plus closing costs. Mortgage

[10] The Alternative QRM Approach (unlike the Proposal) also would permit a junior-lien to exist at the time of closing of a purchase mortgage. PNC does not believe it is appropriate for the QRM definition to include first lien purchase mortgages with simultaneous second lien loans, as these types of loans experienced high levels of default during the recent crisis. For example, unlike in the case of a refinance with a pre-existing junior lien, the borrower in a purchase transaction may have no demonstrated ability to successfully service both the junior lien and the first lien mortgage.

insurance or other third-party credit enhancements could be used in determining whether the borrower meets the combined LTV requirement.[11] Finally, the back-end DTI ratio would be raised from 36 percent to 38 percent (if the borrower's payments under the mortgage could increase by more than 20 percent over the life of the mortgage) or 41 percent (in other cases).[12]

These data suggest that expanding QRM to the Alternative QRM Approach would, like the Proposal, result in rough parity between the QRM and non-QRM segments of the QM market and, thus, help ensure adequate liquidity and appropriate pricing for QM consumers who do not meet the QRM standard. In addition, the data suggest that adopting the Alternative QRM Approach would not significantly increase QRM delinquency rates compared to the proposal, and would continue to encompass only loans that are of very high credit quality. The Alternative QRM Approach would have represented 40.91 percent of the market for the years 2001 through 2011. Looking at 2010 alone, this analysis shows that QRMs would represent 54.67 percent of the QM market.

With regard to default rates, the analysis shows that the Alternative QRM Approach would have produced an average default rate of 0.82 percent for the years 2001-2011. For loans originated in 2006 and 2007, the worst years for default, the Alternative QRM Approach would have produced peak default rates of 2.59 percent and 2.67 percent, respectively. These percentages are not substantially higher than the average (0.65 percent) and peak (2.17 percent) default rates that these data indicate would exist under the QRM definition as proposed. Given the similarities in these data, we urge the Agencies to adopt the Alternative QRM Approach. This will allow more loans to be QRM while ensuring adequate liquidity in the non-QRM QM segment and that QRMs are of very high credit quality with very low risk of default, even during times of stressful economic environments.

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[11] We interpret this prong of the Alterative QRM Proposal to allow for mortgage insurance and other third-party credit enhancements to move the borrower's combined LTV from below 90 percent to the required 90 percent, but would *not* permit a mortgage to be a QRM if the borrower does not contribute enough of his or her own money at closing so that the combined LTV would be more than 90 percent with or without mortgage insurance or other third-party credit enhancements.

[12] Under the Alternative QRM Approach, maximum front-end DTI would be 33 percent if payments under the mortgage could increase by more than 20 percent over the life of the mortgage.

Table 2. Comparison of QRM as Proposed and the Alternative QRM Proposal

Definitions:*	QRM Rule	Definitions:*	Alternate Rule
Debt/Income	36	Debt/Income	38 Arm / 41 Fix
FICO	690	FICO	690
LTV		LTV	
Purchase	80	Purchase	90
Rate Term Refi	75	Rate Term Refi	90
Cash Out Refi	70	Cash Out Refi	75

Year	% Share of total QM Mkt	Volume $B	Life to Date Default	% Share of total QM Mkt	Volume $B	Life to Date Default
2001	28.14	80.00	0.51%	37.35	100.00	0.71%
2002	35.44	250.00	0.36%	45.90	320.00	0.50%
2003	36.70	500.00	0.39%	47.37	640.00	0.51%
2004	26.90	260.00	0.71%	33.84	320.00	0.87%
2005	25.00	230.00	1.42%	31.18	280.00	1.70%
2006	23.07	160.00	2.17%	28.67	200.00	2.59%
2007	21.97	150.00	2.02%	28.75	190.00	2.67%
2008	26.66	130.00	0.60%	38.26	180.00	1.01%
2009	40.59	270.00	0.05%	55.82	370.00	0.09%
2010	40.19	220.00	0.03%	54.67	310.00	0.03%
2011	38.95	40.00	0.00%	51.62	70.00	0.00%
Total:	**31.32%**	**$2,290B**	**0.65%**	**40.91%**	**$2,980B**	**0.82%**

Source of Data: CoreLogic (more than 55 million loans were analyzed)

* All loans are single family and owner occupied, with loan terms of up to 30 years. All loans are fully amortizing with no interest-only features. No front-end DTI screen was applied because data is not publicly available. A screen using a FICO score of 690 was used as a proxy for the credit history criteria for the Proposal.

d. Expanding QRM beyond Alternative QRM Approach

PNC believes that the Alternative QRM Approach represents the outer boundaries that the Agencies should consider for expanding the QRM, keeping in mind the overarching goal of having viable QRM and non-QRM segments of the QM market that can offer loans at prices advantageous to all borrowers, including low-income borrowers. We would not support, for example, removing the LTV and down payment criteria altogether as they force borrowers to have their own "skin in the game" in residential mortgage transactions. Likewise, we do not believe that front-end and back-end DTI should be raised beyond the Alternative QRM Approach or that the front-end DTI ratio should be removed, as some have suggested. A front-end ratio is important to determining mortgage affordability and without it borrowers may be tempted (or encouraged by some lenders) to take on too much housing-related debt.

Furthermore, removing LTV and/or DTI components of QRM would exempt from credit risk retention a substantial majority of the QM market. Not only would this be contrary to the purposes of the statue, it would essentially guarantee a large liquidity premium for the small group of creditworthy QM borrowers that could not qualify for a QRM loan. This would mean that otherwise creditworthy borrowers would be artificially priced out of homeownership.

We also understand that some commenters support defining QRM to be so broad that it is the same as QM. Their concern seems to be that a QRM that is any more narrow than QM will present an untenable barrier to the private mortgage market for lower-income families and new potential homeowners who do not qualify for QRMs because (i) non-QRMs will be too expensive and (ii) the down payment and combined LTV requirements of QRM will require prospective borrowers to wait too long to save money to fulfill those requirements. We respectfully disagree with this analysis, and would strongly urge the Agencies not to define QRM to be coterminous with QM. As we discuss above, creditworthy QM borrowers who do not qualify for a QRM loan will be able to obtain a non-QRM QM loan if the Agencies define QRM narrow enough so that adequate liquidity remains for the non-QRM QM segment of the QM market.

In addition, since QM is likely to be a soft cap on the residential mortgage market, defining QRM to be the same as QM would exempt the vast majority of mortgage loans from the risk retention requirement. Our analysis in Table 3 below shows that under this expanded definition, 84.95 percent of the market between 2001 and 2011 would have been exempt from the risk retention requirements.[13] For 2010, 78.63 percent of the market would have been exempt from risk retention. This would undermine the fundamental purposes of the statute. Certainly, loans subject to the requirement would be the exception, not the rule. Furthermore, looking at the 2001-2011 time period, average default rates for QRMs would have increased nearly five-fold, in terms of the rate of defaults as compared to the Alternative QRM Approach. In addition, CoreLogic data shows that more than 1.18 million "QRM" loans would have gone into default under this broad definition. This represents a ten-fold increase as compared to the Alternative QRM Approach. The reasons for the more substantial increase in the total number of loans that would default as compared to the average default rate is due to the fact that smaller loans tend to have higher LTVs.

[13] The reason our analysis does not show a market share of 100 percent is that we excluded non-owner occupied loans from the definition of QRM, but included them in the QM market.

Table 3. QRM = QM

Definitions:*	QRM = QM Owner Occupied Only
Debt/Income	N/A
FICO	N/A
LTV	
Purchase	N/A
Rate Term Refi	N/A
Cash Out Refi	N/A

Year	** % Share of total QM Mkt	Volume $B	Life to Date Default
2001	90.61	220.00	6.21%
2002	87.66	580.00	3.57%
2003	88.33	1,170.00	2.43%
2004	86.65	790.00	4.04%
2005	84.81	710.00	5.92%
2006	82.26	510.00	8.05%
2007	82.39	480.00	8.21%
2008	79.71	350.00	2.95%
2009	81.32	540.00	0.26%
2010	78.63	440.00	0.07%
2011	77.03	100.00	0.00%
Total:	**84.95%**	**$5,890B**	**3.95%**

Source of Data: CoreLogic (more than 55 million loans were analyzed)

* All loans are single family and owner occupied, with loan terms of up to 30 years. All loans are fully amortizing with no interest-only features. No front-end DTI screen was applied because data is not publicly available. A screen using a FICO score of 690 was used as a proxy for the credit history criteria for the Proposal.

** Market share does not equal 100% because non-owner occupied loans are excluded from definition of QRM, but included in QM market

3. Other Recommendations Relating to QRM

a. Default Mitigation Standards Better Addressed Outside QRM

The Proposal also provides that QRMs must include terms requiring certain servicing policies and procedures that were included by the mortgage originator in the mortgage transaction documents. PNC recommends that the Agencies strike the default mitigation criterion of the QRM. We support efforts to develop uniform national standards for both core and default servicing of *all* new residential mortgage loans. However, the Proposal links servicing standards

to QRM only. This appears to us to be counterproductive because it focuses servicing requirements on the types of mortgage loans that, by definition, are the least likely to actually need default mitigation services. Oddly, under the Proposal, the loss mitigation standards also would not apply to loans securitized by Fannie Mae, Freddie Mac or the Federal Housing Authority. Since these loans represent approximately 90 percent of the mortgage market today, we are concerned that applying servicing requirements to QRMs will slow efforts to develop national servicing standards for all mortgages. Even if they do not hinder these efforts, we are concerned that any default mitigation standards adopted now as part of the credit risk retention regulations would differ or, worse, conflict with the national servicing standards that will be developed and evolving requirements for loans securitized by the government or government-sponsored entities. Thus, these requirements could act as an additional and unnecessary roadblock to the restart of the private securitization markets.

Furthermore, setting loss mitigation standards for QRMs appear to be beyond the scope and intent of section 15G. The statute provides that the Agencies, in defining QRM, consider "underwriting and product features" that indicate a lower risk of default.[14] However, loss mitigation standards relate to a process that is followed upon delinquency or default by a borrower and do not appear to be either an underwriting or product feature. Such standards are typically set as part of the pooling and servicing agreement in a securitization—not at underwriting or origination of the loan.

b. <u>Amend Buy-back Requirements for QRM Pools in __.15(e)</u>

The Proposal rules requires sponsors to buy-back loans in QRM pools that are determined subsequent to the securitization to have not been QRMs at time of origination. Before requiring sponsors to purchase such loans out of the QRM pool, PNC believes it would be more efficient and beneficial to securitizations if the Agencies allow a de minimis level of loans that are determined to be non-QRMs after closing, e.g. 5 to 10 percent of the unpaid principal balance of the pool, to remain in the pool provided that the sponsor—from the initiation of the securitization transaction—holds the required amount of risk retention against the full amount of non-QRM loans that might remain in the pool under this de minimis exception.

We believe this type of exception is fully consistent with the purposes of the QRM exemption. For example, as noted above, sponsors would retain the required amount of risk retention for the full amount of loans that might, post closing, be determined to not be QRMs and remain in the pool. Thus, sponsors would not avoid the risk retention requirements for any such loans. Moreover, PNC believes that QRM securitizations relying on this exception should continue to be subject to the internal control, certification, and disclosure requirements outlined in the proposal. Thus, for example, the issuer would continue to be required to certify that it has evaluated the effectiveness of its internal supervisory controls for ensuring that all loans in the pool are QRMs at closing and determined that such controls are effective.[15] Similarly, sponsors should be required to disclose to investors that the sponsor is utilizing the exception and inform

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[14] 15 U.S.C. 15G(e)(4)(B).

[15] <u>See</u> Proposed Rule at § __.15(b)(4).

investors of when any loans are retained in the pool under the exception and the reason(s) why the loan was determined to not be a QRM.[16]

4. PCCRA should be Eliminated

PNC supports the comments of the Mortgage Bankers Association ("MBA"), the Commercial Real Estate Finance Council ("CREFC"), the American Securitization Forum and others that the PCCRA should be eliminated from the final rule as proposed. We recognize that the Agencies are concerned that a sponsor's monetization of excess spread "could effectively negate or reduce the economic exposure it is required to retain under the rule."[17] However, the monetization of excess spread by sponsors can play a legitimate role in securitizations that are unrelated to eliminating the economic exposure they may have as a result of risk retention requirements. Moreover, because of the variety of securitization structures used across the full range of securitized assets, the PCCRA as proposed would substantially penalize certain types of securitizations even absent the monetization of excess spread and would be inconsistent transaction-to-transaction given changes in interest rates and market conditions. PNC recommends that the PCCRA as proposed be eliminated to allow these legitimate practices to continue. Otherwise, the requirement, as proposed, has the potential to chill the securitization market for all assets.

a. CMBS

As proposed, we believe that the PCCRA would be ineffective as a form of risk retention and would be exceedingly disruptive to the CMBS market (which relies on the sale of the IO strip for expense recovery and a return on capital), and therefore PNC recommends the Proposal be modified to eliminate the PCCRA. In CMBS, the present value of a relatively minor amount of excess coupon captured as first-loss credit support is ineffective as credit enhancement or risk retention. The rating agencies will assign little value to the availability of a relatively minor cash capture, and the sponsors will value it at zero given that it is available as first-loss credit support. In CMBS, the size and duration of the IO strip vary from transaction-to-transaction, as they are created in response to the difference in interest rates between loan origination and securities issuance, differences in fixed coupons for bonds with varying ratings, and variations in the bond investors' appetites for discounted or premium bonds. (For example, in a rising rate environment, there is typically little excess interest remaining to create an IO strip, while in a falling rate environment, the sponsor must create a larger IO strip to accommodate investors' demand for par-priced bonds.) The amount captured in PCCRAs will be inconsistent from transaction to transaction, valued by the sponsor at zero, and will therefore provide no alignment of interest, risk retention, or additional motivation for long-term credit performance. Effective forms of sponsor risk retention to ensure alignment of interests include expanded disclosure (to allow investors to distinguish sponsor alignment of interest); robust representations and warranties coupled with an effective buy-back mechanism upon breach; and the retention by a sponsor of a "vertical" risk retention class in combination with the third-party purchaser.

The creation of the PCCRA has been described by the Agencies as a method to align interests of the sponsors, and in the case of a third-party purchaser, to increase the price paid by the third-

[16] See Proposed Rule at § __.15(e)(3).

[17] Proposal at 24,113.

party purchaser to par by diverting cash flow of the IO strip to the purchaser of the first-loss "horizontal" risk retention. In a CMBS, however, the purchase price of a non-investment grade or unrated horizontal class must be set at a discount to par to reflect the constraints of the interest rate coupon of the underlying loans, the tax implications of using loan interest to pay bond principal or interest, and the need to provide those investors a market rate yield on their unrated or below investment grade rated security. It is expected that some loans in each issuance will default and result in losses. The discount price paid by the subordinate class investor reflects their expectation of receiving less than the contractually obligated principal and interest. Because of the high likelihood that not all loans in the pool will fully pay interest and principal through maturity, and because the subordinate class investor must absorb those losses first on behalf of all investors, it is mathematically and economically necessary that the subordinate class investor purchase its bond at a discount to par.

b. RMBS

As proposed, the PCCRA requirement as applied to RMBS significantly and negatively impacts the ability of originators to utilize the capital markets to appropriately securitize loans with features (such as rate locks) that reduce the up-front costs incurred by consumers in obtaining a mortgage. While we support the goal of ensuring that the risk retention rules are not easily avoided, we do not believe that the PCCRA, as proposed, is the appropriate mechanism to achieve that result.

Both the interest rate obtained by, and the total fees charged to, a consumer are impacted by the way in which the capital markets currently operate. For example, an originating lender can offer a consumer a rate lock because the lender is able to hedge against increases in interest rates that occur during the lock period. In addition, a consumer can obtain a residential mortgage loan with no out-of-pocket expenses in exchange for a minimal increase in interest rate because that rate increase can be securitized with an IO bond. An originator's successful utilization of capital markets tools such as these will permit it to sell a loan at a price that will allow it to recoup the costs of those tools as well as pay for its overhead. However, under the Proposal, if an originator receives such a price, the loan would be considered to have been sold at a "premium" and the funds received to recoup the costs would be diverted to the PCCRA. This will result in lenders not being able to lock the interest rate for borrowers at application. So, if the rates moved up during the real estate sales contract period, many borrowers would no longer qualify for the loan.

In both cases, this would exacerbate the issue of accumulation of funds in order to meet QRM eligibility criteria. In practice, this would mean that consumers would be required to pay those amounts at closing, rather than being able to spread closing costs and origination charges out over the life of a loan via a moderately higher interest rate. In addition to increasing the amount of money that a consumer must bring to the closing table, often an impediment in and of itself, these expenses would likely be considered definitional "points and fees." This could impact the scope of loans that are QMs and, thus, presumed to meet the new ability to repay standards of Title XIV of Dodd-Frank, as well as the high-cost and higher-priced mortgage thresholds in Regulation Z.[18] PNC, like most of its peers, does not make loans that are considered to be "high cost" or "higher priced" under state or federal law. As the rules defining QM are not yet final, it

[18] To the extent that the PCCRA reduces the universe of loans that are QMs, it would also reduce the universe of QRMs.

is unclear what sort of market, if any, will exist for loans that don't meet that definition. To the extent that up-front fees and costs would be considered "points and fees" and cause a loan to exceed the aforementioned thresholds, this would mean many borrowers would simply not be able to acquire a residential mortgage loan. We do not believe that such a result is consistent either with the risk retention rules or any consumer protection laws or regulations.

Rather than adopt the premium capture reserve requirement as proposed, we suggest the Agencies consider adopting an alternative approach to ensuring originators, sponsors, and securitizers are compliance with the new rule. We support both of the two alternative recommendations outlined by the Housing Policy Council in its comment letter: either using market value as opposed to par value for determining risk retention or permitting the use of the vertical slice or representative sample option in lieu of a premium capture account.

5. Specific Issues Relating to CMBS

CMBS is a critical component of the financing of commercial and multifamily real estate in the United States. For more than 20 years, CMBS has been the vehicle by which global investors have delivered capital to local commercial mortgage markets in the United States. During this period, fixed-income bond investors contributed $1.2 trillion in capital to the U.S. commercial mortgage market. Today, CMBS trusts hold approximately 25 percent of all commercial real estate mortgage debt outstanding. It is of paramount importance that the risk retention rules apply to CMBS in a way that will not stifle the continued development of well-designed securitization transactions or restrict market participation to a limited number of institutions. Other holders of commercial real estate loans, which include commercial banks, insurance companies, and the multifamily segments of Fannie Mae and Freddie Mac, would be unlikely to significantly increase their holdings if CMBS became untenable. PNC generally supports the comment letters filed on the proposal by the MBA and CREFC as they relate to CMBS. We underscore below some concerns we have with the Proposal, which are addressed in more detail in the letters submitted by those associations.

a. Forms of Risk Retention

PNC joins the MBA in recommending that the Agencies consider alternative forms of risk retention for CMBS, including, in particular, through loss-sharing arrangements and contractual representations and warranties among counterparties. These arrangements align interests of originators, sponsors and investors just as effectively as "funded" forms of risk retention.

We also urge the Agencies to make modifications to several forms of risk retention permitted under the Proposal to facilitate CMBS transactions. For example, we suggest that section ___.10 regarding risk retention held by an independent third-party purchaser be amended to allow the required risk retention amount to be split between the third-party purchaser, which would hold a first loss position, and the sponsor, which would hold a vertical slice. There is nothing in section 15G that would prohibit dividing up risk retention in this manner and allowing some amount of risk retention to be held by the sponsor. Doing so would better align the interest of the sponsor with investors.

PNC agrees with the comments of other industry participants that the representative sample option for CMBS under Section__.8 is not feasible in its proposed form. As a threshold matter, requiring the designated pool to contain at least 1,000 assets effectively eliminates this as an option for CMBS, as the pools typically include no more than 100 to 200 assets. In addition, the

concept of random selection from the pool assumes that the assets are homogenous, which is simply not the case for CMBS. We recommend that the representative sample option be amended to make it a viable option for CMBS sponsors. For example, holding 5 percent pro rata credit risk of the pool of commercial mortgages either as a security class or a loan participation(s) would be a 100 percent representative sample. Another example is the case of a CMBS which is guaranteed by Freddie Mac or Fannie Mae and for which an originator enters into a pari passu or first loss contract, which would also provide risk retention of a 100 percent representative sample.

b. Exemption for Qualifying Commercial Mortgages

The Dodd-Frank Act explicitly allows the Agencies to develop underwriting standards for "low credit risk" loans which would be exempt from the risk retention requirements. We recognize that the Agencies intended that only a relatively small subset of "low-risk" loans would qualify for the exemption for qualifying commercial mortgage loans. However, as crafted, the exemption is too narrow to be of practical use for any CMBS, as the underwriting standards are not realistic for transactions to be securitized through the CMBS model and virtually no commercial mortgage loan would qualify. We do not believe that crafting such a restrictive exemption fulfills the legislative intent to incent origination of low credit risk loans by providing criteria for such loans which could be met for a meaningful (although small) subset of CMBS loans. It is possible that very stringent criteria have been set for qualified loans because the Agencies set risk retention at zero for loans meeting the underwriting requirements.

We recommend that the qualified mortgage criteria for CMBS be adjusted so that they are consistent with more secure commercial real estate and multifamily underwriting market standards and incorporate enhanced disclosures of loan information for investors. For example, the proposed standards include 20-year amortization and 10-year maturity. While many CMBS loans have a stated maturity of 10 years, a number have 5- or 7-year terms. Many loans have 30-year amortization periods. Allowing various maturity and amortization terms reflects the fact that commercial mortgages are heterogeneous. In addition, the rules should be modified to provide for a reduced sliding scale of risk retention based on the percentage of loans in the collateral pool meeting the underwriting criteria. The MBA comment letter in its section headed "Underwriting Standards for Zero Risk Retention" proposes changes to the underwriting criteria which would make the qualifying commercial mortgage exemption a more viable risk retention option for CMBS.

c. Third-party Purchaser Risk Retention

The practice of allocating a first-loss position to a third-party purchaser (a "B-piece buyer") has been a common practice in CMBS transactions, and is recognized as one of the options for risk retention with respect to CMBS. However, we believe that certain aspects of the proposed regulations will create significant disincentives for the use of the B-piece buyer risk retention option. Limiting the presence of these investors would have a detrimental effect on the viability of CMBS market, the availability of credit and borrowing costs. We are supportive of the suggestions made by the MBA and CREFC regarding B-piece buyer risk retention. We do not believe that the prohibition on hedging the retained credit risk associated with the securitized assets is appropriate for B-piece buyers. Those investors should be able to manage their investments and hedge exposure using available market products. Likewise, we do not agree that a complete prohibition on direct or indirect financing is appropriate for B-piece buyers, although

we recognize that it may be appropriate to impose limitations (such as a requirement that such financing be provided on a recourse basis) to prevent the transfer of the risk to non-qualified parties. We also believe that the requirements in section __.10(b) concerning the sponsor's duty to monitor third-party purchaser compliance with the risk retention rules are not practical. Sponsors do not have access to all the information needed to perform such monitoring. A more workable solution would be to require that periodic certification of compliance by the third-party purchaser be delivered to the trustee and made available to regulators and investors. We believe that a failure to modify the proposed regulations to address the concerns above, coupled with the proposed duration of risk retention (discussed below) could make B-piece investments extremely unattractive and thus severely limit or eliminate such investments as an important component of typical CMBS transaction structures and as a viable option for risk retention.

6. Duration of Risk Retention

Section 15G expressly permits the Agencies to define the length of period that a securitizer or originator must retain its exposure to the credit risk of securitized assets.[19] PNC recommends that the Agencies use their discretion in the statute to reduce the holding period for risk retention for *all* asset classes to something that is shorter than the life of the securitization vehicle. We believe that risk retention need not be for the life of the securities or loans underlying the transaction in order to fulfill its purposes of encouraging sound underwriting at origination.

In all markets, most defaults occur within the first few years of a loan. Losses on the risk retention held by issuers or originators of RMBS most often will occur in the first years after the securitization. In the CMBS market, there has long been transparency with regard to asset performance over time, through reporting and readily accessible data, that allows for early identification of credit problems. This will also be the case for RMBS given increased disclosure requirements for underlying assets. Once deficient underwriting or other performance factors are identified, a sponsor wishing to transfer the risk would see the existence of those factors reflected in the price an investor would be willing to pay for the interest being sold.

Requiring continued risk retention in later years on primarily performing loans would have the perverse result of tying up capital on loans that were underwritten well—as demonstrated by their actual performance. Requiring issuers and originators to continue to retain risk with respect to these well underwritten loans will prevent them from utilizing that capital to make new loans. Thus, PNC recommends a four-year duration period for RMBS assets and a three-year duration period for all other asset classes.

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[19] See 15 U.S.C. 78o-11(c)(1)(C)(ii).

Thank you for your consideration of these comments. If you would like to discuss any aspect of this letter, please do not hesitate to call me.

Sincerely,

Saiyid Naqvi
President and CEO
PNC Mortgage

ATTACHMENT

HISTORICAL LOAN VOLUME AND PERFORMANCE OF QRM ELIGIBLE LOANS

Definitions:*	QRM Rule	Definitions:*	Alternate Rule	Definitions:*	QRM = QM Owner Occupied Only
Debt/Income	36	Debt/Income	38 Arm / 41 Fix	Debt/Income	N/A
FICO	690	FICO	690	FICO	N/A
LTV		LTV		LTV	
Purchase	80	Purchase	90	Purchase	N/A
Rate Term Refi	75	Rate Term Refi	90	Rate Term Refi	N/A
Cash Out Refi	70	Cash Out Refi	75	Cash Out Refi	N/A

Year	% Share of total QM Mkt	Volume $B	Life to Date Default	% Share of total QM Mkt	Volume $B	Life to Date Default	** % Share of total QM Mkt	Volume $B	Life to Date Default
2001	28.14	80.00	0.51%	37.35	100.00	0.71%	90.61	220.00	6.21%
2002	35.44	250.00	0.36%	45.90	320.00	0.50%	87.66	580.00	3.57%
2003	36.70	500.00	0.39%	47.37	640.00	0.51%	88.33	1,170.00	2.43%
2004	26.90	260.00	0.71%	33.84	320.00	0.87%	86.65	790.00	4.04%
2005	25.00	230.00	1.42%	31.18	280.00	1.70%	84.81	710.00	5.92%
2006	23.07	160.00	2.17%	28.67	200.00	2.59%	82.26	510.00	8.05%
2007	21.97	150.00	2.02%	28.75	190.00	2.67%	82.39	480.00	8.21%
2008	26.66	130.00	0.60%	38.26	180.00	1.01%	79.71	350.00	2.95%
2009	40.59	270.00	0.05%	55.82	370.00	0.09%	81.32	540.00	0.26%
2010	40.19	220.00	0.03%	54.67	310.00	0.03%	78.63	440.00	0.07%
2011	38.95	40.00	0.00%	51.62	70.00	0.00%	77.03	100.00	0.00%
Total:	**31.32%**	**$2,290B**	**0.65%**	**40.91%**	**$2,980B**	**0.82%**	**84.95%**	**$5,890B**	**3.95%**

Source of Data: CoreLogic (more than 55 million loans were analyzed)

* All loans are single family and owner occupied, with loan terms of up to 30 years. All loans are fully amortizing with no interest-only features. No front-end DTI screen was applied because data is not publicly available. A screen using a FICO score of 690 was used as a proxy for the credit history criteria for the Proposal.

** Market share does not equal 100% because non-owner occupied loans are excluded from definition of QRM, but included in QM market